DIRECT TESTIMONY OF
THOMAS R. OSBORNE
ON BEHALF OF
SOUTH CAROLINA ELECTRIC AND GAS COMPANY
DOCKET NO. 2002-223-E

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Thomas R. Osborne. I am a Managing Director in the Global Energy and Power Group within UBS Warburg LLC's Investment Banking Department. My business address is UBS Warburg LLC, 299 Park Avenue, New York, NY 10171.

Q. MR. OSBORNE PLEASE STATE YOUR EDUCATIONAL BACKGROUND.

A. I hold a Bachelor of Arts degree, with distinction, from the University of Virginia, where I was elected to Phi Beta Kappa.

Q. WHAT IS YOUR BUSINESS BACKGROUND?

A. As a Managing Director within the Global Energy and Power Group at UBS Warburg, I am primarily responsible for investment banking coverage of regulated electric, gas and water utility companies, independent power producers and related power industry participants. I joined UBS Warburg in May 2001 after spending five years as a Director in the Global Energy Group at Credit Suisse First Boston. Prior to joining Credit Suisse First Boston, I spent nine years (1987-1996) in the Utility Investment Banking Group at PaineWebber Incorporated, holding the titles of analyst, associate, vice president and first vice president. During my fifteen years of investment banking experience, I have worked on transactions with an aggregate value in excess of US$30 billion. I have extensive experience with corporate utility issuers in the equity and fixed income capital markets, and I have advised utilities on numerous mergers and acquisitions ("M&A") and generation asset divestitures, as well as restructurings. In recent years I led the financial advisory team for the proposed divestiture of 3,000 megawatts of electric generation assets by Sierra Pacific Resources and advised Pinnacle West Capital Corp. in a proposed generation asset swap and generation company restructuring. Other transactions for which I have acted as an advisor include: the leveraged recapitalization of DPL Inc. including an investment by Kohlberg, Kravis, and Roberts, the TXU gas processing divestiture, the PG&E Australian Pipeline divestiture, Northeast Utilities' acquisition of Yankee Energy System, Iowa-Illinois Gas and Electric's merger with Midwest Resources, Midwest Energy's merger with Iowa Resources and GTE's acquisition of Contel.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY BEFORE THE PUBLIC SERVICE COMMISSION OF SOUTH CAROLINA?

A. Yes, although the case was subsequently withdrawn.

Q. ON WHAT DATE AND IN WHAT CAPACITY WAS YOUR TESTIMONY PROVIDED?

A. In January 2002, in Docket No. 01-220-6, I provided testimony on behalf of South Carolina Pipeline Corporation with respect to identifying a group of publicly traded companies that faced similar business and financial risks to those of the applicant.

Q. HAVE YOU SUBMITTED TESTIMONY BEFORE OTHER REGULATORY BODIES?

A. Yes. I have previously testified before the Public Utilities Commission of the State of Nevada.

Q. MR. OSBORNE, PLEASE DESCRIBE THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING.

A. South Carolina Electric and Gas ("SCE&G" or the "Company") has requested my expert opinion in identifying publicly traded companies (the "Peer Group") that face business and financial risks comparable to those of SCE&G. The Peer Group is included as Exhibit Nos. __ (TRO-1, 2 and 3), which is attached to this testimony.

Q. PLEASE DISCUSS THE BUSINESS AND FINANCIAL RISKS FACED BY SCE&G AND THE COMPARABLE COMPANIES.

A. As part of my selection of companies for the Peer Group, I gave careful consideration to companies with business and financial risks similar to those of SCE&G.

As primarily regulated utilities, SCE&G and the Peer Group collectively are exposed to similar business risks which include, among other factors, regulatory and legislative actions including rate setting, deregulation and the imposition of environmental controls legislation; fluctuating power demand resulting from a variable macroeconomic environment and/or weather conditions; customer and/or asset concentration; limited ability to alter the generating fuel source in the case of electric utilities; commodity price volatility and fuel supply risk. These risk factors have the potential to materially affect a company's ability to effectively and profitably execute its strategic plan by causing, among other things, higher levels of competition, which could lead to a lower market share and/or a higher risk customer mix; loss of competitive position within the respective service area; increased levels of counterparty risk; increased risk of default on debt obligations or on energy contracts and the resulting operating effects of the inability to execute such transactions; and/or increased exposure to commodity price volatility and other macroeconomic risks. These business risks are captured in metrics such as asset concentration, relative cost competitiveness, the percentage contribution of assets from unregulated businesses, Standard and Poor's business position ranking, fuel supply concentration and customer segmentation.

In my analysis and selection of the Peer Group, I have also focused on financial metrics which provide information on SCE&G's risk-return profile. As with the business risks, SCE&G and the Peer Group collectively are exposed to similar financial risks which include, among other factors, the negative effects that higher interest rates or restricted access to capital can have on capital intensive businesses with high levels of financial leverage, adverse effects resulting from a lack of financial flexibility, as well as a deterioration in cash flows and the resulting ability to service debt and pay dividends. These risk factors have the ability to adversely affect a company by increasing the cost of capital and/or restricting access to the capital markets, reducing financial flexibility thus increasing the cost of financial distress and/or likelihood of default, which could materially affect management's ability to effectively and profitably execute its strategic plan and which could thus negatively impact operating earnings. The financial metrics selected to capture these risks include market capitalization, financial leverage, interest coverage ratios, credit ratings, dividend yield and implied valuation multiples, among others. The rationale for the selection of these metrics was that they provide information and insight into determining a company's risk-return profile as it relates to financial flexibility, quality of earnings and stability of cash flows, sustainability of profit margins and ability to access the capital markets.

Q. PLEASE DISCUSS YOUR CONSIDERATIONS IN DETERMINING A PEER GROUP FOR SCE&G.

A. I have formulated my opinion based on fifteen years of financial industry experience within the utility sector. As you are aware, SCE&G's operations are primarily regulated electric and natural gas businesses. The Peer Group for SCE&G was selected based on a comparison of several key operational and financial metrics across a range of U.S. utility companies from various geographic regions. Among the key metrics I considered are: total market capitalization, capital structure, financial leverage, credit ratings, Standard and Poor's business position ranking, the overall contribution of assets and operational flows from regulated electric and regulated gas operations, the extent of investment in unregulated businesses, and profitability.

The companies in the Peer Group were selected based upon their asset mix being comprised principally of utility operations. I also considered the fact that SCE&G serves approximately twice the number of electric customers as it does natural gas customers and as such employs fixed assets which are weighted towards the generation, transmission and distribution of electricity. Furthermore, SCE&G's financial leverage, credit ratings and profitability, among other factors, suggest that the company should be compared to a peer group with credit ratings near the middle of the investment-grade spectrum. These were my primary considerations when determining the appropriate subset of peers to select from the universe of regulated U.S. electric and gas utilities.

Q. COULD YOU PLEASE DESCRIBE THE FACTORS CURRENTLY INFLUENCING INVESTORS' VIEWS OF ELECTRIC AND GAS UTILITIES AS INVESTMENT VEHICLES?

A. Based in part on the dramatic deterioration in the credit quality of some of the leading industry participants, questions about corporate accounting practices and the impact of proposed regulatory and legislative changes on the utility operating environment, increased regulatory scrutiny, and actual or threatened bankruptcies, the power industry is currently in a state of turmoil. As a result, investors have taken an increasingly critical view of the power sector generally and of those companies that are actively and substantially involved in unregulated merchant energy activities. As has been the case in the broader equity market, there has been a "flight to quality" in the power sector as investors are increasingly being drawn to companies with credible business strategies, transparent accounting and experienced, reputable management teams. Unfortunately, the entire power sector, and not only those companies engaged in unregulated merchant energy activities, is now being perceived by investors as entailing more risk. Consequently, the power sector as a whole and each individual company must provide sufficiently high returns to continue to attract investor capital.

Q. WHAT IMPACT DOES THE REGULATOR HAVE ON THE PERCEIVED RISK OF UTILITY SECURITIES?

A. Capital is a limited financial resource that is allocated only to those entities that meet the risk-return requirements of investors. This allocation of financial resources occurs in the capital markets and as such, the actions of the state regulatory commission are not only a matter of public policy, but also a matter of financial policy as the attention of the financial markets is closely focused on how policies, actions, and decisions of state regulators affect investors' expected returns. The Commission and the Company have reason to give careful and thoughtful consideration to the requirements of the capital markets, because they are the mechanisms which price risk and allocate available capital to the users of capital – corporations, individuals and governments. The Commission's actions on matters such as cost recovery, balancing of customers' and shareholders' interests, quality of service, deregulation, and authorized rates of return materially impact valuation as a result of how adequately the company's expected return compensates investors for their assumption of risk. Much to the credit of the Commission and SCE&G, the Company has been a financially sound utility. The Commission's continued support of SCE&G through its thoughtful and equitable actions is imperative to engendering investor confidence and maintaining a stable operating environment which, in turn, will allow SCE&G to more effectively compete for the capital resources that it requires to provide reliable service at a reasonable cost to its customers. Moreover, the Company's ability to earn reasonable rates of return on its equity is the product of both fair and timely regulatory treatment and positive financial and operating policies instituted by management. Continuation of these policies over the coming years will be critically important to investors in light of the increased competitive pressures and the evolution that is currently underway in the power sector.

Q. WHAT TYPE OF COMPANY WOULD YOU DEEM COMPARABLE FOR PURPOSES OF CALCULATING SGE&G'S COST OF CAPITAL?

A. I would consider an ideal comparable company to be a regulated generator, transmitter and distributor of electricity and natural gas to a stable mix of residential, industrial, and commercial customers. The company would have little in the way of unregulated operations and direct commodity price risk but would carry principally regulatory and operational risk. Lastly, the company would operate in a state(s) which remain primarily regulated at the generation, transmission and distribution levels. To this end, I believe the companies listed in Exhibit Nos. ___ (TRO-1, 2 and 3) accurately reflect comparable companies for SCE&G.

Q. WHY DO YOU VIEW THE COMPARABLES YOU HAVE IDENTIFIED AS APPROPRIATE?

A. There are very few publicly traded companies that have the same business model and business risk profile as SCE&G. For this reason, I have identified companies from two categories: Integrated Utilities with both regulated electric and regulated natural gas operations, as well as Electric Utilities, which based on SCE&G's status as primarily an electric service provider, also provide a fair proxy for the Company. Each of these companies was selected based on its overall comparability and its exposure to business and financial risks similar to those of SCE&G.

These companies are primarily regulated entities that have solid investment-grade credit ratings, have a relatively modest proportion of unregulated businesses, and have manageable exposure to commodity price volatility. These companies are comparable to SCE&G in that they are similar in size and face similar regulatory, operational, environmental, and general financial risk. I believe the Peer Group is thus an appropriate set of comparable companies for evaluating SCE&G's cost of equity capital.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

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TOTAL RETURN ANALYSIS

Company Name	Share Price[1] ($)	Shares Outstanding[2] (mm)	Equity Market Value[1] ($mm)	Indicated Annual Dividend[2] ($)	Dividend Yield (%)	I/B/E/S Long-term EPS Growth[1] (%)	FirstCall Long-term EPS Growth[1] (%)	I/B/E/S Total Return (%)	FirstCall Total Return (%)
DPL Inc.	18.25	126.501	2,309	0.94	5.2	7.5	7.0	12.7	12.2
Energy East	20.36	116.832	2,379	0.96	4.7	6.8	6.0	11.5	10.7
Great Plains Energy	19.79	61.909	1,225	1.66	8.4	4.7	4.0	13.1	12.4
IDACORP, Inc.	25.32	37.612	952	1.86	7.3	8.0	8.0	15.3	15.3
NSTAR	42.25	53.033	2,241	2.12	5.0	6.4	7.0	11.4	12.0
Pinnacle West Capital Corporation	33.05	84.807	2,803	1.60	4.8	6.6	6.0	11.4	10.8
Vectren Corp	23.22	67.730	1,573	1.06	4.6	7.7	7.0	12.2	11.6
Mean					**5.7**	**6.8**	**6.4**	**12.5**	**12.1**
Median					**5.0**	**6.8**	**7.0**	**12.2**	**12.0**

SOURCE: Bloomberg, FactSet,FirstCall and SEC Filings

NOTES:

1. As of 08/01/02
2. As of 3/31/02

Exhibit No. __ (TRO-1)

Exhibit No. __ (TRO-2)

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COMPARABLE TRADING ANALYSIS

Company Name	Symbol	Equity Market Value[1] ($mm)	Total Enterprise Value[1] ($mm)	Total Enterprise Value Multiple: LTM EBITDA (x)	Equity Market Value Multiples: 2002E EPS (x)	Equity Market Value Multiples: 2003E EPS (x)	Equity Market Value Multiples: Book Value (x)	I/B/E/S Long-term EPS Growth[2] (%)	FirstCall Long-term EPS Growth[3] (%)	Dividend Yield (%)
DPL Inc.	DPL	2,309	4,797	7.2	10.9	10.2	2.8	7.5	7.0	5.2
Energy East	EAS	2,379	5,016	6.3	12.4	10.8	1.3	6.8	6.0	4.7
Great Plains Energy	GXP	1,225	2,824	6.3	10.5	9.6	1.6	4.7	4.0	8.4
IDACORP, Inc.	IDA	952	2,210	6.6	17.3	11.0	1.1	8.0	8.0	7.3
NSTAR	NST	2,241	4,792	7.1	12.6	11.7	1.8	6.4	7.0	5.0
Pinnacle West Capital Corporation	PNW	2,803	6,206	5.5	8.8	8.3	1.1	6.6	6.0	4.8
Vectren Corp	VVC	1,573	2,840	8.7	12.9	11.7	1.8	7.7	7.0	4.6
Mean				**6.8**	**12.2**	**10.5**	**1.6**	**6.8**	**6.4**	**5.7**
Median				**6.6**	**12.4**	**10.8**	**1.6**	**6.8**	**7.0**	**5.0**

SOURCE: SEC Filings

NOTES:
1. As of 08/01/02
2. I/B/E/S estimate as of 8/01/02
3. FirstCall estimate as of 8/01/02

Exhibit No. __ (TRO-2)

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COMPARABLE CREDIT ANALYSIS

Company Name	Capitalization[1] Equity Book Value ($mm)	Pfd Stock Book Value ($mm)	Long Term Debt[2] ($mm)	Book Cap ($mm)	Long Term Debt[3]/ Book Cap[1,3] (%)	LTM EBITDA/ Interest (x)	Long Term Debt[3]/ LTM EBITDA (x)	Credit Ratings[5] S&P Senior Unsecured	Moody's Senior Unsecured	S&P Business Position[4]
DPL Inc.	838	315	2,147	3,300	75	4.7	3.7	BBB	Baa1	6
Energy East	1,891	388	2,288	4,567	59	3.7	3.3	BBB	Baa2	3
Great Plains Energy	756	189	1,003	1,948	61	4.5	2.7	BBB	Baa2	6
IDACORP, Inc.	882	104	791	1,777	50	4.8	2.7	BBB+	Baa1	5
NSTAR	1,263	43	1,692	2,998	58	3.8	2.6	A-	A2	3
Pinnacle West Capital Corporation	2,549	0	3,265	5,814	56	nmf[6]	2.9	BBB	Baa2	5
Vectren Corp	875	0	1,014	1,889	54	4.1	3.1	A-	A2	4
Mean					59	4.3	3.0			5
Median					58	4.3	2.9			5

SOURCE: SEC Filings

NOTES:

1. As of 3/31/02
2. Includes long-term debt, minority interests and capital leases
3. Long-term debt includes preferred stock in addition to long-term debt, minority interests and capital leases
4. Standard & Poor's *Utilities & Perspectives* dated July 22, 2002
5. Credit ratings are for senior unsecured debt at the holding company unless otherwise noted
6. Pinnacle West Capital Corporation's LTM EBITDA/Interest coverage ratio is not meaningful in the context of this analysis due to high LTM interest capitalization